Navigating a Changing Sales & Use Tax Environment

The Situation

Sales tax rules and regulations are at a point where the legislation that governs it must evolve to keep up with the changing way business is done. The internet has dramatically impacted consumer purchasing and has allowed businesses to expand at a faster rate. More and more consumers are buying products online, and the development of apps and one-click purchasing has only made it more convenient for consumers to complete purchases. According to the U.S. Department of Commerce, e-commerce sales accounted for over $115 billion in the third quarter of 2017, an increase of 15.5% from the third quarter of 2016.

The increased demand for and growth of e-commerce sales, has resulted in expansion beyond brick and mortar sales. These changes have underlying implications for sales and use tax for buyers, sellers and governing bodies (federal/state/local). The June 2018 Supreme Court ruling in South Dakota v. Wayfair, determined that states can broadly require online retailers to collect sales tax even if they lack a physical presence in the state. As a result, states will be revising and imposing new regulations for online sales tax.

Ever-changing sales and use tax legislation, governed at the state level, has made it more challenging for business owners to stay up-to-date and ensure they are properly complying with these regulations. The complexity in understanding and navigating changing sales and use tax regulations, along with compliance and reporting, has become more burdensome than ever on businesses large to small. This has created a need in the marketplace for CPA firms to help navigate, advise, and consult their business clients.

The key drivers impacting today's market are:

Driver I.
Pursuit of Additional Tax Revenue

Driver II.
Proliferation of E-commerce

Driver III.
Confusion Over SUT Implications

Navigating a Changing Sales & Use Tax Environment examines each one of these drivers, and the impact each has on sales and use tax services as a crucial growth area and marketplace differentiator for CPA firms. It also provides deeper insights into, and a broader understanding of, the steps CPAs can take to provide these services for their business clients, who are among the ever-growing number of organizations feeling the impact of a constantly changing sales and use tax environment.

Key Market Drivers

Driver I. Pursuit of Additional Tax Revenue

Over the last few years states have reported a $23 billion per year loss in tax revenue on average, largely as a result of the increase in internet sales. To combat this loss in revenue, states have responded with aggressive measures to identify and pursue additional revenue sources to offset the multi-billion-dollar shortfall – among these additional revenue resources are sales and use tax.

Up until June 2018, a 1992 Supreme Court ruling in Quill v. North Dakota had served as the sales tax law of the land. Under this ruling, businesses needed to have a "physical presence" in a state for that state to require the collection of sales tax. Many states challenged this decision, in light of the growth of online sales. In the landmark case of South Dakota v. Wayfair, the Supreme Court ruled in favor of South Dakota, expanding nexus beyond "physical presence" to include economic presence, which correlates with a set level of sales or gross receipts activity within a state.

States are on the offensive and have hired additional auditors and are using technology and information-sharing agreements to identify noncompliant businesses. As a result of the Supreme Court decision, states are starting to respond and will be enforcing revised and new regulations for online sales tax. Failure to comply can result in hefty penalties, collected by the state. Ultimately, the business owner is the one feeling the impact.

What is Nexus?

Nexus, is the determining factor of whether an out-of-state business selling products into a state is liable for collecting sales or use tax on sales into the state. Traditionally, nexus was defined by physical presence, but the definition has further expanded to include economic activity within a state. Nexus is created if a company maintains a temporary or permanent presence of people (employees, service people or independent sales/service agents) or property (inventory, offices, warehouses)as well as a level of sales or gross receipts activity within a state.

What are the different types of Nexus?

- **Click – Through Nexus:** If a retailer or service provider contracts with an individual or company located in-state who directly or indirectly refers potential customers to the retailer through a web link for a commission/other consideration upon sale, the retailer is considered to maintain a place of business in that state.
- **Affiliate Nexus:** If an affiliated person of the retailer with a physical presence, or employees or agents in state, has sufficient nexus in state to require the retailer to collect and remit sales and use taxes on taxable retail sales of tangible personal property or services.
- **Economic Nexus:** Generally correlates with a set level of sales or gross receipts activity within the state. No physical presence is required.
- **Marketplace Nexus:** If an online marketplace operates its business in a state and provides e-commerce infrastructure as well as customer service, payment processing services and marketing, the marketplace facilitator is required to register and collect tax as the retailer rather than the individual sellers.

Driver II. Proliferation of E-commerce

To reclaim tax dollars lost due to the changes in the way business is conducted, for example, to e-commerce, states are frequently evaluating and revising their nexus determinations, which has triggered new and complex state and local SUT obligations for businesses. Gone are the brick-and-mortar days when the scope of business rarely reached beyond local communities or state lines. Any out-of-state purchases that took place twenty years ago were typically done by mail order or phone.

Now, there are near-infinite growth opportunities for businesses, from small family-owned operations to large established companies. Among the opportunities is the ability to easily and cost-effectively expand product sales and services into other states and jurisdictions, largely due to thriving online sales capabilities. Online shopping has made it more convenient than ever before for consumers to complete purchases any day and time they choose from a variety of devices including smartphones and tablets.

As more and more internet vendors have expanded sales into other states, the definition of "physical presence" had become largely debated. This resulted in states challenging what constitutes nexus. For example, Massachusetts and Ohio attempted to broaden nexus to include internet retailers that use cookies on their websites that have sales of over $500,000 in the state and have in-state software.

Many attempts by states were challenged in the past, but the decision in South Dakota v. Wayfair, has provided the opportunity for other states to enact new rules that expand nexus to include a certain level of economic activity. South Dakota's law requires remote sellers to register, collect and remit sales tax if they meet the following criteria:

- $100,000 of annual gross revenue from the sale of tangible property, electronic products or services delivered into South Dakota; or
- 200 separate transactions per year in which there is a sale of tangible property, electronic products, or services delivered into South Dakota.

What is In-State software?

Software used by in-state customers on their computers, smartphones, and other electronic and/or communication devices, including information or software such as cached files, cached software, or 'cookies', or other data tracking tools, that are stored on property in the state or distributed within the state, for the purpose of purchasing tangible personal property, prewritten computer software delivered electronically or by load and leave, and/or taxable services.

Driver III. Confusion Over SUT Implications

Sales and use tax regulation presents a double risk to business owners – complex rules and regulations and, if not in full compliance, financial consequences that could impact the survival of the business. The root of SUT compliance challenges for many business owners is the lack of a complete understanding of SUT requirements, implications and liabilities, ranging from tax collection to remittance.

It is often the case that business owners fail to realize that they have reached a stage in their business, in terms of sales revenue, where compliance has been triggered in their jurisdiction. Nexus rules differ from state to state and jurisdiction to jurisdiction and can be expected to continue changing, especially in light of the recent Supreme Court decision – the confusion around what creates nexus can leave businesses vulnerable. In other cases, businesses may understand the need to comply, though in-house expertise and resources are not sufficient to ensure complete compliance.

The differences in state nexus rules can create situations where an activity creates nexus in one state, but due to a different state's laws, does not create nexus in another state for the same activity. To add to the complexity of determining which states a business has sales tax nexus, once those states are identified, the registration process varies from state to state.

What about consumer use tax?

There has been a lot of attention brought to determining and complying with sales tax, but businesses must also determine the taxability of what they purchase and cooperate with states regarding consumer purchases when sales tax isn't collected. This occurs when the buyer does not pay sales tax on an item because the seller doesn't have nexus in the buyer's state, typically purchases made outside a state or online. The buyer must self-assess the use tax and remit payment to the state for the storage, use or other consumption of tangible personal property.

An Example: Colorado's Notice and Reporting Law

Remote sellers with over $100,000 in Colorado customer sales that do not collect sales tax must comply with the following:

1. Notify Colorado customers of their obligation to pay Colorado use tax at the time of purchase. or face penalties ranging from $5 per transaction to $50,000 for each provision:

2. Provide an annual summary each year to Colorado customers that spend more than $500.

3. Provide the Colorado Department of Revenue with a customer report that includes their names, addresses and total purchases by March 1 each year.

What else makes sales tax complicated?

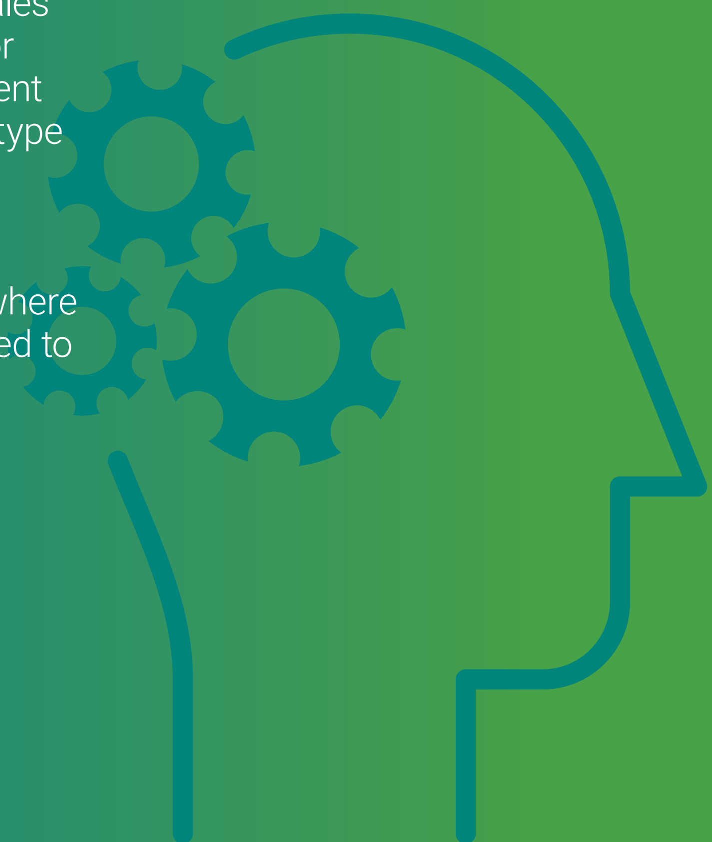
1. **Sales tax rates:** Rates vary across the country, and can be subject to additional taxes of the county and city too. Rates can also differ depending on the product or service.

2. **Filing due dates:** Filing returns are due on the 20th day of the month after the taxable period ends in most states. Other states have a due date of the 15th, the last day of the month, or another date.

3. **Frequency of filing:** Sales tax filings are typically due monthly, quarterly or annually, though some states have semi-annual or fiscal annual frequencies.

4. **Exemption process:** Certain non-profits and others who qualify may be exempt from sales and use tax. There is a different process for obtaining an exemption certificate in different states and some have limits based on the type of non-profit and type of transaction.

5. **Use tax:** Even though a seller may not be required to collect sales tax from a buyer where they don't have nexus, they may be obligated to notify buyers of use tax obligations.



Expanded Trusted Advisor Role

As mentioned, the transformation of the business environment through examples such as e-commerce has substantially changed the landscape of sales and use tax regulations, resulting in increasingly complex reporting and compliance. The Wayfair decision could potentially impact any business that sells goods remotely. Companies could be required to collect and remit sales tax in up to 45 states. For business owners, sales and use tax noncompliance can result in interest and penalties that can threaten the future of their business. This underscores the need for CPA firms to become trusted advisors to their business clients.

As a trusted advisor, the CPA firm has an opportunity to expand their service offerings around sales and use tax, by providing greater collaboration and partnership to their business clients. In most cases, the CPA firm knows the ins and outs of their client's business, sometimes even better than the client. Using their expertise, CPA firms can provide consultative advisory services and take advantage of an emerging outsourcing opportunity to offer compliance services. The consequences to the CPA firm for neglecting to take on this role can range from jeopardized client relationships to lost revenues.

While the types of services that a CPA firm provides can vary depending on the firm, current sales and use tax services offered and the level of expertise, there are immediate and recurring revenue service opportunities that all CPA firms can take advantage of.

The immediate service opportunities available to firms are focused primarily on consultative and advisory options, such as nexus studies, product taxability analysis, audit defense, and more. These services allow the CPA firm to advise and consult a client through the confusion of nexus determination, understanding product taxability rates and, preparing and helping a client understand where they might be vulnerable if an audit were to arise. These services can be quite lucrative for CPA firms ranging anywhere from a couple hundred dollars to thousands of dollars per engagement, as they tend to require a high level of expertise, time, and understanding of the current sales and use tax regulations. Most often we find these types of services performed by specialized SUT professionals within a SUT or Tax practice.

The recurring service opportunities available to the firm focus on outsourcing of compliance services, including sales and use tax return filing, submitting payment and assisting clients with notices. By providing these types of services, the CPA firm has transferred the burden of return filing off of the client to the firm, and allows the client to focus on their business. The CPA firm has extended their service offering to the client by providing these services on a recurring basis - monthly, quarterly and annually. Since the majority of these compliance services are ongoing engagements, a streamlined and efficient process is imperative for a CPA firm to experience the benefits of providing such services.

Opportunity Powered by Technology

In today's day and age, it is never recommended to add or enhance a service, especially a service around sales and use tax, without evaluating the technology that powers that opportunity. Creating a successful long-term business offering is done by leveraging technology and having access to best of breed tools.

The technology and tools available must accurately stay up-to-date with the complex and changing SUT requirements, including the changing and expanding product taxability rates, updated forms, and offering a streamlined and efficient workflow to the accounting professional.

Automation Advantage

As presented in the opportunity above, many CPA firms may consider the ROI of SUT services. The role of automation in SUT management is crucial to all CPA firms. Without automation, the service offering can become time consuming, non-efficient and a burden to the CPA firm, resulting in lost profits.

Sales and use tax technologies provide compliance solutions for CPA firms that are reliable, flexible, and built based on a knowledge platform of the most up-to-date rules and regulations. In the process, these solutions eliminate the risks inherent in manual approaches, while delivering a competitive advantage and the following benefits to the firm:

- Time Savings: Many CPA firms that provide outsourced compliance services to clients in multiple jurisdictions find that they must manually access and remit the returns on each individual jurisdiction website. Not only is this a time-consuming process, it opens the door to the possibility of manual errors. By taking advantage of automation, a CPA firm can save time by submitting all returns through a streamlined workflow process.

The research and reporting time saved through automation allows CPAs to deliver SUT services to a greater number of clients in need of compliance guidance. It also creates the opportunity to provide additional revenue-generating services to clients and devote more time to business-development efforts across service areas.

- Increased Accuracy: With tens of thousands of changing SUT rates in thousands of jurisdictions, a trusted technology-based solution that ensures the accuracy of compliance information is an invaluable resource that delivers must-have benefits – from reduced audit risk to higher client - satisfaction levels – to both CPAs and their business clients.

- Enhanced Client Relationships: CPA firms are no longer just tax preparers or bookkeepers, they are trusted advisors and business consultants. By partnering with a trusted technology-based solution, as an advisor the CPA firm will have available the pertinent business information to address questions and inform clients on the overall tax implications in areas including changes to their product offering, and/or expansion into a new jurisdiction. By leveraging automation and technology, the CPA firm becomes an extension to the success of their client's business all while enhancing their overall relationship and asserting the CPA firm's value.

Road to a New Service

With disruptions in the business environment and resulting complexities in SUT compliance, showing no signs of subsiding, CPAs should understand both the need to provide SUT services to clients and the revenue-generating opportunities they present. Their first question then becomes: How can I get started?

Each CPA firm has its own DNA that reflects its unique management philosophy, growth strategy, range of resources and employee capabilities, thereby preventing a one-size-fits all model for SUT services.

Consideration should be given to the people, processes and technology that will drive the best results. The guidance below can serve as a road map, to be customized as needed, for firms that are taking those important first steps toward a SUT service offering.

Existing Capabilities:

Firms should review current client-service offerings across state and local tax (SALT) or outsourcing departments, to determine if there are staff members currently providing any type of SUT services. An existing capability can lead to a collaboration among staff and pooling of resources for a more comprehensive, firm-wide offering. Also, adopting a long-term vision for the service and identify any additional staffing and other resources needed for growth.

Business Plan:

Creating a business plan that outlines a strategy for providing services and identifies resources, including staff is an important step. Services can be provided through a firm's SALT department, CAS practice or a combination of the two. Firms should determine the pricing model and service description, such as:

Compliance Services
- Set-up and implementation of a SUT automation solution
- SUT return filing
- Ongoing SUT evaluation

Advisory Services
- Nexus studies
- Product taxability analysis
- Jurisdictional registration
- Voluntary disclosure agreement

Employee Buy-In:

With the engagement of partners and other staff members, taking the opportunity to explain the service's current and future benefits, in terms of higher revenues and enhanced client relationships.

Staff Empowerment:

Appointing a champion to incite firm-wide support and advocacy, and drive the service offering from research to official launch. The champion also serves as a designated point person for service-related questions and, with assistance from a task force when necessary, monitors and communicates progress, and is accountable for enhancing the service as needed.

Technology Due Diligence:

Researching and evaluating the full range of technology options and select a system that aligns with the SUT business plan and service offerings, and meets the customer-support, on-demand client/firm-access and workflow-automation needs. Also keeping in mind that the most effective SUT solutions are cloud-based and offer a robust accountant console, allowing staff to properly support clients.

Multi-Level Training:

Providing continuing education and training for employees who currently have SUT experience as well as those who have limited knowledge, though have the interest in, and potential for, providing the service. Training programs can range from white papers and other technical resources to presentations and classes. Training, and the raised awareness it creates, can also assist employees in identifying current and potential clients in need of SUT services.

Systemized Rollout:

Launching the service slowly and thoughtfully, beginning with a few select clients. A gradual service introduction provides the opportunity to more quickly and easily identify and resolve any technology, workflow, staff or related issues that may arise.

Continual Improvement:

Reviewing the efficiency, profitability and client impact of SUT services on an ongoing basis, and adjust the business plan as needed to ensure maximum returns and ultimate success.

Next Steps:

There has never been a better time to reach out to clients to increase your trusted advisor role. There may be some confusion about how to comply with changes resulting from the Supreme Court decision, and clients need help navigating them. Firms can help businesses prepare by taking the following next steps:

- Conduct a nexus study and product taxability review. Review business activities and sales in different states and identify where there is risk under traditional, physical nexus and economic nexus.
- Prioritize states where the company has the greatest economic presence and create a plan to register to collect and remit sales tax.
- Evaluate technology that offers the following:
    - Calculates correct rates
    - File and remit payments
    - Maintains exemption certificates

Conclusion:

The evolution of business operations and consumer purchasing has impacted all involved – consumers, governing bodies, but especially business owners. Creating both opportunities and tax obligations, the internet has the potential to expand businesses at a faster rate than ever before. As businesses are achieving increased revenues, they must be mindful of the implications of their expanded sales and the states in which they have nexus. Some businesses fail to realize that they must comply with these new regulations, while others are confused, overwhelmed or don't have sufficient resources to comply. In all cases, there is a need for an advisor to help navigate the confusion. Technology not only offers an efficient way to handle this work, but also positions firms to build a lucrative service line. CPA firms that choose to partner with their clients to address this need will discover great benefits – recurring revenue, but most importantly providing more value for their clients.

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